

PRO-COMPETITIVE ASPECTS OF INTELLECTUAL PROPERTY POOLS: A PROPOSAL FOR SAFE HARBOR PROVISIONS

A submission to the United States Department of Justice Antitrust Division and
the Federal Trade Commission Joint Hearings on Competition and Intellectual
Property Law and Policy in the Knowledge-Based Economy.

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It has been my privilege to participate with the Antitrust Division in the process which resulted in issuance of two of the three principal Business Review Letters which address patent or intellectual property pools.¹ I respectfully suggest that these letters, containing a careful and thorough analysis of the competition issues implicated by intellectual property pools, have withstood the test of time. While actual experience with pools over the last several years may require additional thought and refinement at the margin of the Division's analysis, the basic message the Business Review Letters convey regarding the Division's enforcement intentions should remain unchanged.

While those Letters continue to be the definitive analysis of the competition aspects of intellectual property pools, the Division's effort to provide owners of intellectual property guidance on licensing is not new. More than a quarter century ago, licensing guidelines – referred to as the “nine no-no's” – enumerated practices that were viewed as per se violations of the antitrust laws. Subsequent experience with licensing left many of these principles in doubt, and the “nine no-no's” were formally abandoned in a 1986 speech by the then assistant attorney general.²

Similarly, experience subsequent to the issuance of the Business Review Letters has provided additional guidance on licensing and intellectual property pools. That experience has shown that certain characteristics of pools, if present, make such pools always or almost

¹ Business Review Letter from Hon. Joel I. Klein to Garrard R. Beeney (June 26, 1997), available at <http://www.usdoj.gov/atr/public/busreview/1170.htm>; Business Review Letter from Hon. Joel I. Klein to Garrard R. Beeney (Dec. 16, 1998), available at <http://www.usdoj.gov/atr/public/busreview/2121.htm>.

² See Anthony, Antitrust and Intellectual Property Law: From Adversaries to Partners, 28 AIPA Q.J. (2000).

always pro-competitive. Therefore, set forth below are nine guidelines – “nine yes-yesses” if you will – which provide a framework for a possible safe harbor for intellectual property licensing pools.

The Role of Intellectual Property Pools

Before addressing these nine suggestions, however, it is important to note the role of intellectual property pools in today’s economy. No one can seriously dispute the increasingly high cost of research and development. Whether it is for new products for home entertainment, faster integrated circuits, new drug developments, or the like, billions of dollars are spent each year on research and innovation. In 2000, R&D expenditures grew to 1.8% of gross domestic product.³ Private sector R&D expenditures grew at a formidable 17% annual rate from 1995 to 2000, exceeding \$200 billion by the end of the decade.⁴

The high cost of development and increasingly competitive global markets has increased the need to minimize development costs and reduce risks that development initiatives fail to create marketable products. This, in turn, has led to two significant developments. First, there is an increasing trend toward product standardization. Consumers and industry participants alike are understandably reluctant to embrace a new product – however desirable – that is offered in multiple formats which are often incompatible. The oft cited battle between the VHS and Beta formats, in which numerous consumers were left with useless video players, is just one example of why many products are standardized before their introduction.

Growing initiatives at product standardization also are fueled by the development of products requiring multi-industry participation. For example, while there would be no DVD format without the technology it employs, the consumer electronics industry which developed the technology would have sold very few players indeed if content owners had not made video available in the DVD format. Moreover, cooperation between the content and player technology industries was not sufficient. Had another industry, loosely defined as digital rights management, not provided some measure of copy protection technologies, few can doubt that content owners would not have released content in a digital format capable of producing virtually limitless perfect copies on optical disks.

In addition to product standardization, the high cost of research and development has led to a second trend: greater joint development of single products by multiple industry participants, as companies attempt to share the risks and costs of new product development.⁵

³ Economic Report of the President, February 20002 at 130.

⁴ Economic Report of the President, January 2001 at 111.

⁵ One notable exception to these trends has been drug development. While the pharmaceutical industry historically has relied on exclusivity and intellectual property protection to prevent others from manufacturing particular compounds, even that
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What does all this have to do with intellectual property pools? The two phenomena mentioned above – product standardization and joint product development – naturally and inescapably lead to a proliferation of intellectual property held by numerous companies covering a single product – a phenomenon Professor Shapiro has referred to in these proceedings as the “patent thicket.”⁶ Heller and Eisenberg, in their 1998 article, “Can Patents Deter Innovation,” referred to the fact that blocking patents owned by multiple entities often must be cleared to produce a product as “the tragedy of the anti-commons.”⁷

The growth of patent thickets has been fueled not just by product standardization and joint development, but also by the explosion in the number of patent applications and patent grants. The United States Department of Commerce reports that both patent applications and grants doubled between 1988 and 2000.⁸

Consequently, product manufacturers, in addition to undertaking the traditional marketing analysis of whether expected sale price will exceed cost by an acceptable margin, also must frequently ask whether intellectual property holders will even permit the manufacture and sale of products covered by intellectual property rights and, if so, whether a demanded royalty rate will be at a level the market for the downstream product can bear. When the product at issue is covered by the intellectual property of a single entity this analysis is difficult; when the product is covered by the rights of multiple entities, the analysis – in any reliable sense – may be all but impossible.

One solution to clear the patent thicket is, of course, the creation of an appropriate intellectual property pool. Indeed, Professor Shapiro calls the pool the “purest solution” to the intellectual property bottleneck.

No better example of a pro-competitive solution to the patent thicket can be found than the pool formed around MPEG-2 video compression technology. The pool currently contains approximately 100 patent families owned by 21 licensors. The ability to license all these various rights in a single license at a reasonable and well-known royalty rate meaningfully

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historical business model has begun to change as the industry increasingly relies on joint development because of the high cost and risk of research and development.

⁶ Carl Shapiro, Navigating the Patent Thicket: Cross Licenses, Patent Pools and Standard Setting (March 2001).

⁷ Heller and Eisenberg, “Can Patents Deter Innovation? The Anticommons in Biomedical Research,” Science, 280, 698-701.

⁸ U.S. Department of Commerce, Patent and Trademark Office, 2001 TAF Special Report – All Patents, All Types, January 1972 – December 2000, U.S. Government Printing Office, 2001.

assisted hundreds, if not thousands, of enterprises to enter the various markets for products which employ MPEG-2 technology. Without the MPEG-2 pool, each of these companies would be faced with negotiating multiple licenses, paying multiple royalties, and only guessing at the amount of their ultimate royalty obligation. Indeed, it is fair to question whether MPEG-2 technology would be even close to the success it is today without the MPEG-2 patent pool.

Thus, it is appropriate to begin analysis of intellectual property pools by emphasizing that, in a proper form, pools are good. In the very simple but nevertheless eloquent words of Professor Richard Gilbert at an earlier hearing “licensing is a good thing. We would like to have more of it, not less of it.”⁹ The 1995 Antitrust Guidelines for the Licensing of Intellectual Property acknowledge that pools “may provide pro-competitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions, and avoiding costly infringement litigation.”¹⁰ Pools promote licensing and open many markets that otherwise would be plagued by the growing patent thicket.¹¹

Thus, the question that should be addressed is not yes or no to pools, but rather how to balance the measures necessary to licensors and licensees to facilitate formation and use of pools with guidelines intended to minimize any harm to competition or consumer welfare. Nine such guidelines are discussed below. If a pool is formed in accordance with these nine characteristics it will, absent unusual circumstances, drastically increase confidence that a particular pool is pro-competitive. Indeed, with further refinement, these nine concepts may in fact be developed into safe harbor rules to guide the marketplace.

A few caveats: No suggestion is intended to imply that pools not characterized by the factors discussed below should be condemned. In individual circumstances there may be good and sufficient reasons why the absence of one or more of these factors is competitively neutral or even pro-competitive. Second, none of these concepts is intended to be applied – or, for that matter, not applied – to intellectual property licensing by a single intellectual property owner.

Several of these nine guidelines are merely refinements of the division’s analysis in the patent pool Business Review Letters, the 1995 Antitrust Guidelines for the Licensing of

⁹ Testimony of Professor Richard Gilbert, February 6, 2002 at 93.

¹⁰ U.S. Department of Justice and Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property (1995), at § 5.5.

¹¹ The concept of patent pools as a good and pro-competitive solution is not new. During World War I the federal government, fearful that sufficient aircraft would not be manufactured because of blocking patents held by several companies, suggested that patent holders form a patent pool to relieve the potential bottleneck. See “Cross Licensing and Antitrust Law,” Hon. Joel I. Klein (May 2, 1997), available at <http://www.usdoj.gov/atr/public/speeches>.

Intellectual Property, and the Commission's determination in the VISX case.¹² Others arise from actual experience with intellectual property pools. These nine characteristics can be conveniently divided into three rules for the type of intellectual property that is licensed, three rules for terms restricting the behavior of licensees, and three rules governing the conduct of licensors.

Guideline No. 1 – A Defined Field of Use

First, an intellectual property pool license – to qualify for safe harbor consideration – must define a field of use, i.e., the license should clearly define the scope of the license grant in terms of a particular product or standard. Generally, pool licenses contain such standards. MPEG-2 compression technology, DVD's, Photorefractive Keratectomy ("PRK") eye surgery, the IEEE 1394 data bus, and compact discs are just some examples of pools which precisely define the scope of the license grant in terms of a defined product or standard.

At earlier sessions of these Hearings, some have suggested that pools should be limited to industry standards, but such a rule is unnecessarily restrictive. Many pro-competitive pools formed around products or proprietary standards would be excluded. Yet, in order to assess the competitive impact of a pool particularly on the innovation and downstream product markets, the license should clearly delineate a field of use. Otherwise questions such as whether patents in the pool are complements or substitutes – a significant issue – are essentiality meaningless.

Guideline No. 2 – Most Intellectual Property In the Pool Must Be Complements

The second guideline to increase confidence that a pool is not anti-competitive is that most of the intellectual property licensed by the pool must be complements and not substitutes. In evaluating a pool, a question of unparalleled significance is what is being licensed – what's swimming in the pool. The complaint of the Commission in VISX challenging the combining of patents in a pool that were, in effect, pure substitutes for the only two approved methods for PRK eye surgery was demonstrably sound. Pooling there – used to eliminate competition between two competitive packages of intellectual property rights, either of which could be selected by an ophthalmologist, was an anticompetitive agreement restricting price competition.

On the other hand, some departure in minor respects from the Division's Business Review Letters may be warranted. Not all intellectual property rights licensed in a pool must be complements for the pool to be pro-competitive.¹³ Why should intellectual property that are

¹² See www.ftc.gov/os/caselist/d9286.htm.

¹³ Of course, the question whether a pool may include substitutes or complements is not the same as whether an intellectual property pool must include only intellectual property that is essential to the product defined in the field of use. Patents may be essential to the (continued ...)

substitutes be permitted in a pool? The reason is based on the typical process of setting a standard or product protocol. In an attempt to create an open standard, or a least restrictive protocol for a product, there may be manufacturing steps, calculations or processes that must be accomplished in order to produce the defined product, but which may be accomplished in more than one way. The step to be performed is essential – like crossing water on a journey to Europe – but there may be different ways of getting there – ship or jet. This is sometimes referred to as “mandatory options.” In effect, the standard mandates that the step be performed but does not identify a particular method to do it. The IEEE 1394 standard for high speed data transfer is an example.

By way of illustration, assume the following:

(1) A pool is formed in which the downstream product or field of use is defined as a dedicated integrated circuit (“IC”) with defined specifications.

(2) To function, the IC must receive electrical signals within specified parameters.

(3) The required signal can be delivered in 3 different ways, each of which is covered by a single patent which is not infringed by the other two alternative methods. Thus, A owns a patent on method A, which patent does not infringe methods patented by B or C; B owns a patent on method B, which does not infringe method A or C; and C owns a patent on method C, which does not infringe methods A or B. In effect, the patents are pure substitutes for methods of delivering electrical signals within the defined parameters and if that were the license field of use, under the quite appropriate analysis by the Commission in VISX, such a pool should be challenged.

On the other hand, in a pool in which the field of use is the IC – and the method of signal delivery only a part of that product – the fact that there are three patented alternatives for the signal gives rise to three alternative possibilities for the “IC pool”:

First, inclusion of any of the 3 patents could be barred under a “no substitutes – complements only” policy. Such a rule would thereby increase transaction costs, decrease the efficiency of the pool, and likely increase the monetary costs for those seeking intellectual property coverage. Under this alternative, the IC manufacturer would need a pool license and a license from one of A, B or C.

Second, the pool licensors could choose one of the methods patented by A, B or C and include the selected method in the pool. Under this rule, the pool would not contain patents

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manufacture of the downstream product defined by the license and still be substitutes, or patents may be peripheral to the product and yet be complements. The issue of “essentiality” is discussed below.

that were substitutes, but the process of selection might disproportionately reward one intellectual property holder, perhaps effectively exclude the other two from the market, and limit the licensee's choice of which method to employ.

Third, we could permit inclusion of the competitive intellectual property owned by A, B and C in the pool and let licensees choose which method to use. It would seem from an efficiency point of view, not to mention the interests of the licensee, that the last of these three possible rules is clearly the most sensible and, indeed, pro-competitive.

Any principles permitting substitutes in a pool must nevertheless guard against the behavior demonstrated in VISX. One guideline to accomplish this goal would be to provide that the intellectual property in the pool must be complementary, except that intellectual property which are substitutes may be included to the extent one of the substitutes must be infringed to produce or create the downstream product defined by the license field of use. Moreover, such substitute intellectual property, standing alone, could not be used to produce the defined process or product without infringing the bulk of intellectual property offered by in the license.

This, or a similar concept, guards against a pool being used to restrict competition and fix prices between or among truly competitive packages of rights, while at the same time increases the efficiency of pools for which a mandatory element of the field of use may be satisfied in more than one patented way.

One possible refinement of this guideline to further decrease the incentive to form pools for anti-competitive reasons would be to require that the share of royalties attributed to the intellectual property that is competitive be distributed to licensors in proportion to actual use. For example, and again using our hypothetical IC pool, we could require that royalties be distributed to A, B or C based on the proportion of licensees' use of A, B or C's method. This can be done by (1) requiring licensees to report which methods their chip uses (if doing so is feasible without significantly increasing transaction costs), (2) relying on available industry statistics on which chips are type A, B or C, (3) commissioning an independent estimate of the proportion of chips that use each method, or (4) other reliable ways. By requiring royalties to follow actual use, the incentive to pool substitute intellectual property for anticompetitive reasons is vastly reduced. Under this proposal, an intellectual property holder receives royalties only if its patent is infringed.

Guideline No. 3 – Intellectual Property For Which a Royalty is Collected Must be “Essential” to the Defined Field of Use

The final of the three guidelines concerning the intellectual property offered by the pool license concerns the issue of “essentiality.” The intellectual property licensed by the pool for a royalty must be essential to the product defined by the field of use, although licensors also should be permitted to offer licensees non-assertion agreements (or an equivalent) for all intellectual property of a licensor that would be infringed by a licensee's particular implementation of the product defined by the license field of use.

What is Essential

Intellectual property will be “essential” for purposes of this concept if, as a practical matter (considering production costs and industry practices), the product defined in the field of use cannot be produced without infringing the particular intellectual property. Moreover, in order to be essential, the intellectual property must, of course, be valid. Both invalid patents, once determined to be so, and expired patents should be deleted from a pool license.

The Division’s Business Review Letters have discussed two general approaches to the definition of “essentiality.” The first, “technically essential,” provides that the intellectual property must read directly on the specification of the product defined by the license field of use or it is not essential. This is the approach taken by the MPEG-2 pool. The second approach “commercially essential,” provides that intellectual property also will be considered essential if, as a practical matter, it would be infringed in producing the defined product. “Practicality” is generally judged by whether it would be cost-effective or sensible in the real world to design around the intellectual property at issue. If not, the intellectual property is commercially essential. The 6C DVD pool defined this concept by the phrase “no realistic alternative”, the 3C DVD pool used the phrase “essential as a practical matter.”¹⁴

Either definition is acceptable under a competition analysis. From the point of view of the licensee, a pool license has little utility if it does not enable the licensee, as a practical matter, to produce the product for which the licensee signed the license. As long as the defined field of use is faithfully applied, few competitive issues should arise from including within a pool patents that are either technically or commercially essential.

Non-Assertion Agreements

There are several reasons, however, to take the Business Review Letters analyses a small step further. Provided certain safeguards are met, licensors should be free to offer licensees a non-assertion agreement on non-essential intellectual property that could be infringed by a licensee carrying out the activity contemplated by the license. This non-assert would provide a “free pass” to licensees who are paying a royalty on the licensor’s essential intellectual property in the event the licensee infringes a licensor’s non-essential intellectual property by producing the product defined by the license field of use.

Experience with intellectual property pools confirms that it is rare for a licensor to pursue a licensee for additional royalties for the production of a product for which the licensee already is licensed, even if that production infringes intellectual property not licensed by the pool. Thus, permitting licensors to offer non-assertion agreements would conform with the experience of intellectual property pools, and would thereby increase the transparency of precisely what the licensee is obtaining by executing the license.

¹⁴ See 3C Letter, *supra*, n. 1 Letter from the Hon. Joel I. Klein to Carey R. Ramos (June 10, 1999), available at <http://www.usdoj.gov/atr/public/busreview/2485.htm>.

While it is true that “everyone’s doing it” generally is not a compelling rule of reason defense, permitting the offer of non-assertion agreements in pool licenses is justified because doing so is pro-competitive. The typical analysis supporting a rule which excludes non-essential intellectual property from a pool is based on principles of tying. If licensors are going to license all the intellectual property in a pool only as a package, then the licensee should need a license under all the patents, i.e., all patents must be essential to the field of use. At base, the concern is that purchasers or licensees not be burdened with the cost of products they neither desire nor need, and that market power in one product not be used to foreclose competition in another.

While this analysis is sound when applied to sales of “widgets” in packages, it is not generally applicable to the analysis of offering a package of intellectual property rights. Indeed, one reason why permitting the inclusion of non-essential intellectual property is pro-competitive is premised in part on the fact that intellectual property is different from other property. While it is true that the 1995 Guidelines state that intellectual property will be treated as a form of property, intellectual property bears several characteristics that make it different from other forms of property. One of those unique characteristics is that the marginal or incremental cost to a licensor of licensing additional intellectual property generally is zero. Absent hypothesizing some purely theoretical, and in the context of intellectual property pools not real, opportunity costs, a pool licensor sustains no marginal cost by offering with its essential intellectual property for which a royalty is paid, all its intellectual property that may be infringed by a particular implementation of the product defined by the license.

Although it may be clear in the typical tying case that a purported justification that the tied product is a “gift” which purchasers accept at no cost is generally a subterfuge, that general conclusion is based on the fact that the tied product has an actual cost to the seller who has incorporated a price for the tied product in the price of the tying product. With respect to intellectual property, however, such skepticism is unwarranted. The package of non-essential rights – here the hypothetical tied product – truly has no marginal cost, and in fact, as a practical matter, no real value to the licensor with respect to pool licensees who are not going to be pursued for additional royalties in any event. There is no reason to presume that the pool royalty includes a hidden “charge” for offering a non-assert with a license. Moreover, the fact that the non-assertion is offered to the licensee without compulsion is yet another reason why such a pool license should be permitted and not be considered an impermissible tie.

Offering a non-assert on all intellectual property that may be infringed by a licensee’s production of the product defined by the license field of use also does not constitute the use of market power in the tying product (essential patents) to foreclose competition in either the tied product (rights covered by the non-assert) or any downstream product. The addition of the non-assert merely provides comfort to a licensee which has decided to license the essential package of intellectual property rights to produce the specified product. The license field of use will limit the scope of the non-assert to the standard or product already defined by the license – no separate products or standards are implicated. Thus, there is no foreclosure in any discernable market.

Moreover, there is a further characteristic of intellectual property pools which further safeguards against the offer of a non-assert giving rise to competitive concerns that a pool license royalty is higher because of the inclusion of non-essential intellectual property. Typically pool license royalty rates are governed by market forces. In fact, many pools have reduced their royalty rates over time. The Philips-Sony CD pool and the MPEG-2 pool are just two examples. Indeed, the MPEG-2 pool has reduced its royalty rate by almost 40% while tripling the number of licensors and almost quadrupling the number of licensed patent families since its inception in 1977. This is hardly the behavior of a consortium with monopoly power.

There are many reasons why the royalty rates of intellectual property pools are governed by market forces. First, the only way to convince a prospective licensee to sign a license is to make the license terms acceptable or sue. The alternative of suing a large number of prospective licensees is impractical, costly, and in the pool context, frequently impeded by the free rider problem. Why should one pool member sue and be subjected to the risk and vagaries of litigation, and bear the cost of litigation in dollars and time if, in fact, several co-licensors will benefit from the suit without ever assuming such costs. Infringement cases based on patents licensed by a pool are, in fact, rare.

Second, infringement suits in the pool context also are unusual because even one suit may impede the entire licensing program and deprive licensors of income, as prospective licensees await the outcome of litigation that may take years before deciding whether to sign a pool license. Thus, pool licensors typically will attempt to find terms, including price, that are acceptable in the marketplace. The two well-publicized MPEG-2 licensor infringement actions brought first against Compaq Computer Corporation and then against Dell Computer Corporation are not exceptions to this rule. Those suits were brought only after the marketplace had clearly accepted the MPEG-2 royalty rate, and both defendants had for years refused to sign either pool or individual licenses.

Thus, by allowing licensors to offer non-assertion agreements the pool license becomes more transparent – what generally is implicit in the marketplace becomes explicit – licensees are given greater certainty of their freedom to manufacture and compete by offering different implementations of the defined product without fear of additional claimed royalties, and few, if any, legitimate competition concerns are raised.

Who Determines “Essentiality”

Another significant consideration under the “essentiality” issue is once essentiality is defined, who determines it? The obvious candidates are an independent expert or the licensors. No hard and fast rule is necessary. The integrity of the process of selecting essential intellectual property generally is self-regulating for the following reasons: First, if the licensors in the pool adopt a royalty sharing system that is not directly related to the amount of intellectual property each licensor contributes to the pool, there is no incentive to load the pool with non-essential intellectual property. Indeed, if adding a non-essential patent or two does not increase a licensor’s royalty share, the incentive, if there is an incentive at all given the marginal value of non-essential patents (*see* p. 9, *supra.*), is to exclude not include marginal or clearly

non-essential patents from the pool. Excluded patents might later be used for defensive reasons, i.e., employed to resolve an infringement case brought against the licensor.

Second, while a pool in which a licensor's proportionate share directly depends on the amount of intellectual property a licensor contributes to the pool appears to create incentives to add marginal or non-essential patents, some would argue that this same system creates countervailing incentives for patent holders to challenge each other's patents as non-essential (if a licensor can reduce other licensors' patents in the pool then its share of the royalty revenue rises as the denominator in the formula used to distribute royalties decreases). While it is true that fear of retaliation may ameliorate this incentive, a patent holder which has acted appropriately by including only essential patents may have no fear of retaliation if it mounts such a challenge, particularly if the cost of a challenge to the essentiality of intellectual property is born by the losing party, as is the case in some pools.

Third, there is at least one powerful disincentive for licensors to knowingly include non-essential intellectual property in the pool. If, indeed, the legality of a pool turns in part on whether the intellectual property being licensed is essential, then it will only be sensible for licensors to make an honest effort to follow the rule. The benefit is too little – either the licensor's royalty share is unaffected or it incites challenges by other licensors – and the risk too great – royalty income may be suspended – to intentionally include non-essential intellectual property.

Thus, although there are powerful incentives for licensors to provide for an independent review of the essentiality of intellectual property in a pool – e.g., it has proven to be a persuasive “marketing” tool in communications with prospective licensees – the guideline on essentiality should not require it.

Guideline No. 4 – Grant Back Clauses Generally Should Be Royalty Bearing, Non-Exclusive, and Similar in Scope to the License Grant

The next three suggested guidelines concern restrictions placed on licensees by the terms of the pool license. The first concerns grant back clauses. A grant back clause should generally (1) be non-exclusive, i.e., the licensee should be free to license to others the intellectual property which must be granted back; (2) be limited to the scope of the license grant; and (3) should permit a licensee to collect a reasonable royalty for any license it grants.

The typical concern with grant back clauses – clauses which generally require a licensee to license its intellectual property back to the licensors and other licensees of the pool – is that such provisions inhibit innovation.¹⁵ If a licensee is required to grant back its intellectual property rights without corresponding benefits, then the licensee is unlikely to bear the cost of innovation. Any such concern is significantly ameliorated by a grant back provision which (1) allows the licensee to collect reasonable royalties – even if “reasonable” is defined by the

¹⁵ See, e.g., Guidelines, *supra*, n. 10 at § 5.6.

royalty level collected by licensors; (2) does not require a blanket grant back for any use of the licensee's intellectual property, but rather only for use in connection with the product defined by the pool license field of use; and (3) is non-exclusive so the licensee is free to reap whatever benefits it can from its intellectual property from prospective licensees who are neither licensors nor licensees of the pool license.

While such a grant back clause minimizes any disincentive to innovate, the grant back in a pool license is pro-competitive. It prevents intellectual property owners outside the pool who are licensees from blocking competition in the downstream product market by asserting intellectual property and either refusing to license it or attempting to license it at exorbitant rates. The availability of a pool license may encourage many to enter a market and make considerable investment commitments. The grant back clause prevents a licensee from taking advantage of this, and the distortion it may create for the market value of the licensee's intellectual property. Limited by the three factors discussed above, grant backs are pro-competitive and raise little countervailing disincentives to innovate.¹⁶

Guideline No. 5 – Licensees Should Be Free to Develop Competing Products and Standards

Pool licenses should not restrict a licensee from producing, using or developing technologies other than those being licensed. While it may be legitimate for licensors to ask their co-licensors to use the particular systems or produce the particular product that is being licensed to further the creation of a new product or market, there is little justification for preventing a licensee from using other products or developing other systems, particularly those that may be competitive with the product or system being licensed.

Guideline No. 6 – There Should Be No Discrimination Among Similarly Situated Licensees

The final of the three guidelines directed to licensee conduct is that a pool license should not discriminate among similarly situated licensees. The conduct of a licensee, its status in the market place, its potentially competitive position with respect to a licensor or licensors should not determine the terms of the license offered. This guideline must make plain, however, that the non-discrimination rule applies only among those licensees which are similarly situated.

¹⁶ In at least one context, the requirement that a grant back be royalty bearing may be unnecessary. If a pool license essentially provides access to a well-defined system by offering licensees the right to create products within the system without fear of infringement claims, requiring licensees to provide identical access to their intellectual property even without a royalty creates no disincentive to innovate. On balance, such a grant back will be pro-competitive because, among other reasons, each licensee has a reciprocal obligation to provide access to the system thereby opening the market for the benefit of each licensee, and the licensee grant is limited to the system defined by the license and does not extend to other licensing activities.

For example, there is nothing anti-competitive, or indeed illogical, in seeking different royalty rates from those who use the licensed intellectual property to produce different products. The fact that licensees using a process to manufacture a PC are asked to pay one royalty does not mean that a manufacturer of jet engines – using the same intellectual property to produce a much higher valued product – is entitled under a non-discrimination guideline to pay the same royalty as the PC manufacturer.

Moreover, while the competitive status of a licensee should not determine whether it is offered a license, its place in the distribution chain of a particular product may. For example, the non-discrimination concept should not prevent a licensing program from offering licenses only to licensees who compete at a particular level in the distribution chain. The possibility of a pool adopting such a limitation is based on the doctrine of “exhaustion.” An intellectual property holder generally exhausts its intellectual property rights when it collects a royalty on a product for all the rights it may license. No further royalty on that particular product may be collected. It may, for example, constitute patent misuse to collect a royalty on the same product from a manufacturer, a distributor, an importer and a retailer. Thus, it is competitively acceptable for a pool license to be available only to, e.g., manufacturers of products rather than also to distributors, importers or retailers. Making the license available to all in the distribution chain would make it virtually impossible to determine whether a royalty and just one royalty has been paid on a single product that passes through each of these distribution levels. Thus, for these reasons and others, the requirement of non-discrimination should be limited to those licensees which are similarly situated.

**Guideline No. 7 – Competitively Sensitive Information of Licensees Should Not Be Available to Personnel of Licensors
Who Are Responsible for Competing With One Or More Licensees**

The final three guidelines relate to the conduct of licensors. First, mechanisms should be in place in the licensing program to insure that competitively sensitive information of licensees – e.g., sales prices or identity or location of customers, should not be available to those responsible for competing with a licensee. Keeping such information confidential can be accomplished in several ways. First, with an independent licensing administrator, confidentiality provisions may be a matter of contract among licensors and the licensing administrator.

Second, if the administrator of the licensing program is a licensor, a “wall” can be established within the administrator-licensor such that competitively sensitive information available to licensing personnel is not made available to those within the same company responsible for competing with one or more licensees. Absent any reason to believe such a wall is ineffective, an independent licensing agent should not be an absolute condition to this guideline provided confidentiality is observed in other verifiable ways.

**Guideline No. 8 – Licensors Should Be Free to
Develop Competing Products and Standards**

Licensors themselves should be free to develop products that compete with those defined by the license field of use. The licensing joint venture among licensors should not and

need not create a bar to the development of better or less costly products. While it is legitimate for licensors to agree to use or manufacture the product or process they may be promoting through the pool license, that agreement should not prevent the development or use of superior technologies.

Guideline No. 9 – The Pool License Should Be Non-Exclusive for Individually Owned Intellectual Property

Finally, the pool license should not be the exclusive source of intellectual property rights offered by the license. Each licensor should retain the right to license outside the pool intellectual property rights it individually owns. Under this guideline, the pool will be only an alternative source for licensing individually owned intellectual property, and licensees which are dissatisfied with the terms offered by the pool would always have the opportunity to seek a license under intellectual property which is owned by a single licensor.

While prospective pool licensees may argue that the alternative of individual licenses is illusory, that assertion is really a “complaint” that the pool terms are comparatively too good to turn down. It is in fact the case that but for the pool license, licensees would have no choice but to negotiate individual licenses. The fact that the pool has created an attractive alternative does not render the choice of individual licenses meaningless.

Conclusion

In conclusion, intellectual property pools serve an important pro-competitive goal of clearing the “patent thicket.” Pools ease the introduction of new products and contribute to the creation of numerous downstream product markets. The nine topics discussed above generally address aspects of pools which may raise competitive concerns and pools which resolve these issues in accordance with the guidelines will promote competition and increase consumer welfare absent extraordinary circumstances.

These nine guidelines are intended to create a possible safe harbor or presumption that a pool will withstand a rule of reason analysis. They are not meant to suggest either that pools which do not comply are somehow illegitimate, or that the Division should cease its very important practice of providing guidance to those forming pools through the issuance of business review letters. Finally, these concepts are not in any way meant to apply to an individual intellectual property owner’s licensing of its own intellectual property.

As suggested earlier, the question is not whether to permit or forbid the formation of patent pools, but rather to identify those licensing practices that advance the undeniable pro-competitive aspects of pool licensing without causing unjustifiable or countervailing competitive harm. As Chairman Muris stated on February 6 when these proceedings began “intellectual property and antitrust law both seek to promote innovation and enhance consumer welfare.”¹⁷ These sentiments were shared by assistant Attorney General James who observed

¹⁷ Comments of The Honorable Timothy J. Muris, February 6, 2002 at 5-6.

that “intellectual property and antitrust law share the common purpose of promoting dynamic competition and thereby enhancing consumer welfare.”¹⁸

Principles of intellectual property and antitrust law can be harmonized in the context of intellectual property pools, and the guidelines discussed above are offered to advance that goal.

¹⁸ Comments of The Honorable Charles James, February 6, 2002 at 1.